

State of Rhode Island and Providence Plantations
STATE INVESTMENT COMMISSION

Monthly Meeting September 22, 2010

A State Investment Commission (SIC) meeting was held in Room 135, State House, Providence, Rhode Island on Wednesday, September 22, 2010. The Treasurer called the meeting to order at 9:04 a.m.

Membership Roll Call. Present were: Ms. Rosemary Booth Gallogly, Mr. Michael Costello, Ms. Marcia Reback, Mr. Andrew Reilly and General Treasurer Frank T. Caprio, establishing a quorum. Also present were: Ms. Sally Dowling, of Adler Pollock, & Sheehan, and Mr. David Ursillo, of Rodio & Ursillo, Legal Counsel to the Commission; Mr. Allan Emkin and Mr. John Burns of Pension Consulting Alliance (PCA), General Policy Consultant to the Commission; and members of the Treasurer's staff. Mr. Thomas Fay, Mr. Robert Gaudreau, Mr. Robert Giudici, and Dr. Robert McKenna were not present.

State Investment Commission Minutes. Treasurer Caprio entertained a motion for approval of the minutes for the meeting of August 25, 2010. Mr. Costello moved, Ms. Booth Gallogly seconded, and the subsequent motion passed. The following members voted in favor: Ms. Booth Gallogly, Mr. Costello, Ms. Marcia Reback, Mr. Reilly and General Treasurer Caprio.

VOTED: To approve the Minutes of the August 25, 2010 monthly meeting.

General Consultant Report. Treasurer Caprio called on Mr. Emkin to provide background on the private equity consultant request for proposals (RFP) and the prospective consultant presentations that will take place today.

Mr. Emkin commented that the investment staff issued the RFP for a private equity consultant and evaluated the responses with input from him and others at PCA. The three candidates believed to be the most capable to work with the board and the staff will give short presentations and answer any questions. Listening to these presentations is part of the boards general due diligence and a selection decision is not expected today. He noted that he has worked with each of these groups on more than one occasion and that neither he nor PCA has a business relationship with any of them. Mr. Goodreau stated the presenters have been instructed to be general in scope. Anything that the group may want to address in more detail can be done by conference calls or site visits. Each presentation will be 15 minutes followed by an opportunity for questions. They will proceed in alphabetical order by firm.

Mr. Dennis Sugino, the President of Cliffwater LLC, introduced himself and his colleagues, Managing Directors James Feidler, and Gabrielle Zadra, and gave brief education and career summaries. He

noted that Tom Lynch, who has over 25 years of consulting experience, from their NY office, would be the relationship service person.

Mr. Sugino then asked the group to turn to page 3 of the Cliffwater presentation booklet. He stated that Cliffwater is an independent advisory firm, with no partners, and is employee owned. They advise globally on \$9 billion in private equity and have 26 clients overall. They are registered with the SEC and have no regulatory issues. The firm aims to be a leader in thought, service and performance.

Mr. Feidler told the group that the firm utilizes disciplined and documented due diligence exclusively in the alternative investment arena. He noted that the firm services only institutional investors and has many advantages including: access to top tier funds, a customized approach, a disciplined investment process and an experienced team. The team that would be available to the Rhode Island fund would be comprised of 18 professionals with extensive experience that would cover the following areas: portfolio strategy and construction, private equity sourcing and due diligence, and monitoring and operations.

Ms. Zadra explained that the Cliffwater team reviews 300 to 400 opportunities each year. The team is proactive in researching and identifying the top performing funds by strategy and in building relationships with those firms. There is a firm investment committee that meets several times a month to review all approved funds. There is also a forward calendar of funds that are coming to market in the next 18 months. This process is important to construction of a

portfolio that is diversified by time, strategy and geography.

Ms. Zadra said that Cliffwater has built a proprietary data base of over 2000 funds to track the funds they monitor and the funds they perform due diligence on. They produce a quarterly client memo on the top ranked funds that they are active in due diligence on and the best funds coming to market in the next year.

Mr. Fiedler commented that he and Tom Lynch of their NY office would lead the dedicated consulting team but the entire staff is available to Rhode Island.

Mr. Sugino provided a summary of Cliffwater's advantages including: they engage in customized advisory services only; the firm is the proper size to give clients access to funds; and Rhode Island would be one of their top clients.

Treasurer Caprio asked for the proposed fee structure.

Mr. Sugino said that the fee is \$400,000 for non-discretionary services and \$700,000 for discretionary services.

Ms. Booth Gallogly asked how do they balance due diligence with maintaining access and relationships with the funds they would recommend.

Ms. Zadra said the general partners do protest the level of information we require but many eventually commend our thoroughness and the firms that will not provide the required information are not the type we will recommend to our clients.

Mr. Mike DiMartile, Vice President of Hamilton Lane introduced himself and his associates, Vice President Mike Koenig, Managing

Director Andrea Kramer and Chief Executive Officer Mario Giannini.

Mr. Giannini asked the group to turn to page 2 of the presentation material. He stated that Hamilton Lane is an independent, global firm, the majority of which is owned by over 40 employees with their funds invested along side the client's. Hamilton Lane is a recognized leader in private equity; they are the largest of advisory firms in the asset class with \$15 billion in assets under management. The client base is 50% U.S., including top pension funds, and 50% non-U.S. The diverse base gives the staff an understanding of what others are doing in the asset class globally.

Mr. Giannini noted that the firm provides discretionary and nondiscretionary management with a customized strategy. The type and depth of services depends on the client's needs and can be modified as needs change. They offer the specialized strategies of: co-investments, secondaries, and fund-of-funds.

Ms. Kramer told the group that she is part of the investment team and heads the global offices. The team of 31 professionals has allocated over \$12 billion during the past two years in all of the various strategies. Hamilton Lane has a proprietary data base to evaluate and track all the information they receive and for client monitoring.

Mr. Giannini commented that every general partner that Hamilton Lane reviews is top quartile. The firm's track record is something they are very proud of, as is the extensive network of contacts with the LP and GP community. These factors enhance the due diligence, monitoring and reporting functions.

Mr. Costello asked how often they say no to a general partner when

that person holds an advisory seat.

Mr. Giannini replied about 20% of the time. He provided additional insights on board participation.

Ms. Kramer remarked that it is a challenging conversation, but our decision process is the same every time.

Mr. Koenig spoke about the process of customizing the diligence process for each client through defining objectives and guidelines.

Mr. Giannini stated their goal is to understand what the client needs and utilize their staff and systems to meet that need.

Mr. Goodreau asked for information on the proposed fee structure.

Mr. Koenig explained that the fee for taking over the legacy portfolio for monitoring and reporting is \$200,000.00. Going forward with investment management services for new commitments there would be a tiered fee; 75 basis points for up to \$150 million and the fee would come down at certain points as you invest more. Additionally, there are fee options for legal services.

Ms. Davidson of Pacific Corporate Group Asset Management (PCG) introduced David Fann, President and CEO and Scott Reining, Vice President.

Mr. Fann provided an overview of PCG, a specialist private equity firm that provides customized services tailored specifically for each client. The firm has invested over \$44 billion for clients globally. He explained the firm's investment philosophy is to deliver strong investment returns and exceptional service on a custom basis. This is accomplished through business practices including a

research-driven investment process, term negotiation to add value and diligent monitoring and reporting.

Mr. Fann stated that in the past year representatives of PCG worked with the White House. They have also worked with the Federal Reserve Board and the U. S. Treasury Department and several states. Since 1995, PCG has continually generated top quartile rates of return, outperforming the benchmark during the entire time Rhode Island has been their client.

Ms. Davidson said the history of working with Rhode Island for the past 15 years to build the private equity portfolio from the ground up sets PCG apart from other firms. PCG's longevity and standing has aided in Rhode Island's ability to secure allocations in the top performing funds. They have worked with each administration to assemble a top performing private equity portfolio.

Ms. Davidson commented during the current administration, PCG has actively participated in optimizing the portfolio. They executed 2 successful secondary sales; the first was innovative at the time and the second rebalanced the portfolio. Each was priced at the peak, resulted in a gain and saved millions in fees.

Ms. Davidson reviewed the 7 member team dedicated to Rhode Island's customized services and noted that there are an additional 32 investment professionals providing support.

Mr. Reining told the group that PCG has a record independently verified in compliance with Global Investment Performance Standards (GIPS). Since 1990, PCG has exceeded public and private market benchmarks on an aggregate basis. They have also consistently

exceeded benchmarks on a vintage basis with periods of significant out performance relative to the benchmark. Of the funds PCG selected, 40% have been first quartile and 70% have been first or second quartile.

He stated the Rhode Island track record, on an aggregate basis or a vintage basis, mirrors that of PCG. Rhode Island's since inception performance is 14.4%, which is well above public and private benchmarks.

Ms. Davidson addressed the question of relationship structure posed in the RFP, stating that PCG would be pleased to continue the 15 year relationship on a non-discretionary basis or could provide discretionary services for all or part of the program.

Mr. Costello asked for clarification on the difference in the discretionary and non-discretionary programs.

Ms. Davidson commented that depends on how the program is set up and there are many relationship options that can be employed to meet your objectives.

The group discussed the various aspects of the discretionary / non-discretionary relationship structure.

Mr. Dingley asked how the discretionary accounts perform relative to the non-discretionary accounts.

Ms. Davidson stated the accounts are very similar; both are included in the performance numbers you see.

Ms. Booth Gallogly asked why a discretionary program has a higher fee.

Mr. Emkin clarified that the fee is higher because the fiduciary duty

and liability is shifted away from the board and there is the back office accounting and administrative work to be considered.

Mr. Reilly asked for a performance projection for year end 2010.

Ms. Davidson said it will likely be slightly higher from where it is now.

Mr. Goodreau asked Ms. Davidson to review the fee structure.

Ms. Davidson told the board that to maintain what we are doing now, where everything stays the same, PCG proposed \$337, 000. This is the same as the current agreement. We are prepared to discuss alternate structures.

The group briefly discussed the private equity consultant topic.

Legal Counsel Report. Legal Counsel had no report.

Cash Management Report. Mr. Izzo stated that he and Mr. Marr would like to introduce a new type of investment, the Local Government Investment Pool (LGIP), for the state's short-term portfolio which would improve our yield and preserve safety and liquidity. He asked the group to refer to the handout Discussion regarding Creation of State and Local Government Pool. Our research shows that 44 out of 50 states including all of the other New England states have investment pools consisting of state, municipality and quasi agency funds.

Mr. Marr commented that the guidelines would be the same as those the SIC prescribes for the state's short-term cash. The LGIP would create operational efficiencies and the opportunity for increased yield. An outside manager would be utilized. At a future meeting we

will present a more detailed proposal.

Ms. Booth Gallogly asked if each individual government entity would deal directly with the outside manager.

Mr. Izzo replied that each entity would have direct access to the outside manager and get their own statements.

Mr. Marr stated that the LGIP is a trust that would sell units of participation.

Treasurer Caprio asked what size the pool would be.

Mr. Izzo stated that right now the state has an average of \$500 million in short-term funds. With the state and full quasi agency participation, the LGIP be between \$500 million and \$1 billion dollars and with municipalities it would be a billion plus size fund.

Mr. Marr stated the yield pick up achieved by other LGIPs in our region is anywhere from 15 to 20 basis points over comparable investment vehicles, which earn 5 to 10 basis points. There would be a significant amount of additional revenue for the state and participating municipalities.

Chief Investment Officer Report. Mr. Goodreau stated that the fund was above the benchmark for the month and it is about 95 basis points ahead for the year.

Treasurer's Report. Treasurer Caprio reported that last year and this year we compared the Rhode Island fund performance to that of the Harvard endowment and to the states of Massachusetts and California. For the second year in a row Rhode Island is

outperforming all three.

New Business. There was no new business.

There being no new business, the Treasurer entertained a motion to adjourn. Mr. Costello moved, Ms. Booth Gallogly and Mr. Reilly seconded and the subsequent motion passed. The following members voted in favor: Ms. Booth Gallogly, Mr. Costello, Ms. Marcia Reback, Mr. Reilly and General Treasurer Caprio.

VOTED: To adjourn the meeting.

There being no further business, the meeting was adjourned at 10:56 a.m.

Respectfully submitted,

**Frank T. Caprio
General Treasurer**